Indemnification of Trustees from Liability for Negligence

Introduction

1. The role of trustee is ordinarily an onerous one. The duties of a trustee range from the fundamental fiduciary duties to act in good faith and in the interests of the beneficiaries, through duties to take skill and care in the administration of the trust, to immutable obligations to act in accordance with the terms of the trust instrument and not to act in a manner which is not authorised by that deed or by the court. In light of the wide range of obligations and responsibilities of a trustee, it is not uncommon for trustees to find themselves in breach of trust and accordingly liable to the beneficiaries whom they serve.

2. The natural corollary to the risk of liability faced by trustees is their desire to limit those risks through exclusion of liability clauses in the trust deed. Thus, trustee exemption clauses, designed to give the trustees protection against actions for breach of trust, have become common place and no modern trust deed is complete without some detailed trustee exemption clauses.

3. The duty on a trustee to act always in the best interest of the beneficiaries and the purposes of the trust often collides violently with the trustee's natural desire to protect itself against claims from beneficiaries for breach of trust. This unhappy tension has led to a plethora of litigation.

Irreducible Core Duties of the Trustee

4. The normal duties of a Trustee are perhaps well known. A trustee is expected to manage the affairs of the trust for the benefit of the beneficiaries in a prudent and sensible manner.

5. What have been referred to as “irreducible core duties” of a trustee include:

   i. a duty to carry on the business of the trust with the degree of prudence to be expected of a hypothetically reasonably prudent man of business

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1 Speight v Gaunt (1883) 9 App Cas 1 and In re Whiteley, Whiteley v Learoyd (1886) 33 ChD 347, 355.
ii. a duty to inquire into the extent and nature of the property and the trusts

iii. a duty to obey directions in the settlement save where some departure is authorized by the court

iv. a duty to account for the stewardship of the assets under the trustee’s control

6. The elements of this irreducible core duty of a trustee particularly the duties expressed at i. and iv. above raise the interesting question of the extent to which trustees can be exempted from liability in cases of their own negligence causing loss and or damage to the trust fund and its beneficiaries. This paper seeks to examine the state of the law leading to and after the Privy Council decision in *Spread Trustee Co. Ltd. v. Hutcheson et al* 4

Discussion

7. We start this discussion with reference to a troika of cases decided in the English Courts.

8. The first and most seminal is the decision by the English Court of Appeal in *Armitage v Nurse* 5, the Court had to consider the meaning and effect of a typical exemption clause found in many trust deeds:

“No Trustee shall be liable for any loss or damage which may happen to Paula’s fund or any part thereof or the income thereof at any time or from any cause whatsoever unless such loss or damage shall be caused by his own actual fraud”.

9. It was argued for the beneficiary that the reference to fraud must be taken to include equitable fraud so that the exemption from liability was far narrower than the plain language would suggest. The beneficiary argued that conduct falling short of dishonesty was sufficient to fix the trustee with liability notwithstanding the language employed in the trust deed. The Court of Appeal did not agree.

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2 *Hallows v Lloyd* (1888) 39 Ch D 686; *Nestlé v National Westminster Bank Plc* [1993] 1 WLR 1260;
3 *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378
4 [2012] 1 All ER 251
5 [1997] EWCA Civ 1279
10. Millet, LJ delivered the leading decision and reasoned the clause meant what it said so that actual fraud was required. That in turn required dishonesty on the part of the trustee and nothing less. A negligent trustee, indeed even a grossly negligent trustee, was protected from liability and hence the consequences of his negligence. Millett LJ put it thus:

“[The clause] exempts the trustee from liability for loss or damage to the trust property no matter how indolent, imprudent, lacking in diligence, negligent or wilful he may have been, so long as has not acted dishonestly”.

11. The argument was further advanced by the beneficiary that the clause was repugnant to good public policy especially as it purported to exempt a trustee from liability for gross negligence.

12. The Court of Appeal held that only a clause which purported to exclude liability for fraud would be considered repugnant and contrary to public policy. Thus the exclusion clause in favour of the trustee was allowed. There was it seemed no particular magic in negligence however gross. The Court of Appeal put the matter thus at page 253:

“I accept the submission ... that there is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts. But I do not accept the further submission that these core obligations include the duties of skill and care, prudence and diligence. The duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries is the minimum necessary to give substance to the trusts, but in my opinion it is sufficient. As Mr. Hill pertinently pointed out in his able argument, a trustee who relied on the presence of a trustee exemption clause to justify what he proposed to do would thereby lose its protection: he would be acting recklessly in the proper sense of the term.

It is, of course, far too late to suggest that the exclusion in a contract of liability for ordinary negligence or want of care is contrary to public policy. What is true of a contract must be equally true of a settlement. It would be very surprising if our law drew the line between liability for ordinary negligence and liability for gross
negligence. In this respect English law differs from civil law systems, for it has always drawn a sharp distinction between negligence, however gross, on the one hand and fraud, bad faith and wilful misconduct on the other. The doctrine of the common law is that: "Gross negligence may be evidence of mala fides, but is not the same thing:" see Goodman v. Harvey (1836) 4 A. & E. 870, 876, per Lord Denman, C.J. But while we regard the difference between fraud on the one hand and mere negligence, however gross, on the other as a difference in kind, we regard the difference between negligence and gross negligence as merely one of degree. English lawyers have always had a healthy disrespect for the latter distinction. In Hinton v. Dibbin (1842) 2 Q.B. 646 Lord Denman C.J. doubted whether any intelligible distinction exists; while in Grill v. General Iron Screw Collier Co. (1866) L.R. 1 C.P. 600, 612 Willes J. famously observed that gross negligence is ordinary negligence with a vituperative epithet.

The submission that it is contrary to public policy to exclude the liability of a trustee for gross negligence is not supported by any English or Scottish authority. The cases relied on are the English cases of Wilkins v. Hogg 31 L.J.Ch. 41 and Pass v. Dundas (1880) 43 L.T. 665; and the Scottish cases of Knox v. Mackinnon (1888) 13 App.Cas. 753, Rae v. Meek (1889) 14 App.Cas. 558, Wyman v. Patterson [1900] A.C. 271 and Clarke v. Clarke’s Trustees, 1925 S.C. 693. These cases, together with two other Scottish cases, Seton v. Dawson (1841) 4 D. 310 and Carruthers v. Carruthers [1896] A.C. 659, and cases from the Commonwealth and America, were reviewed by the Jersey Court of Appeal in Midland Bank Trustee (Jersey) Ltd v. Federated Pension Services Ltd. [1996] P.L.R. 179 in a masterly judgment delivered by Sir Godfray Le Quesne Q.C.

In Wilkins v. Hogg, 31 L.J.Ch. 41 Lord Westbury, LC accepted that no exemption clause could absolve a trustee from liability for knowingly participating in a fraudulent breach of trust by his co-trustee. But, subject thereto, he was clearly of opinion that a settlor could, by appropriate words, limit thescope of the trustee’s liability in any way he chose. The decision was followed in Pass v. Dundas, 43 L.T. 665, where the relevant clause was held to absolve the trustee from liability. In the course of his judgment Sir James Bacon VC stated the law in the terms in which counsel for the unsuccessful beneficiaries had stated it, viz. that the clause protected the trustee from liability unless gross negligence was established; but this was plainly obiter".
13. The second in the troika of cases was *Bogg v Raper*\(^6\). The English Court of Appeal had to determine whether the trustee exemption clause in that case was sufficient to protect a trustee against the charges made.

14. Millett LJ again was pressed into service. The litigants accepted that the exemption clause should be restrictively construed and that anything which was not clearly within it should be treated as falling outside it. Only clear and unambiguous language could be used to exclude liability. The beneficiaries then argued that the Court should go farther and construe an ambiguous document more strongly against the maker of that document. This is a principle drawn from the law of contract. The Court of Appeal refused on the basis that exclusion of liability clauses in the trust setting are usually the words of the settlor and not necessarily those of the trustee. Since trustees accept office on the terms of a document for which they are not responsible they are entitled to have the document fairly construed according the natural meaning of the words used. Applying this approach, the Court found that the clause did indeed give protection to the trustees.

15. This approach by the Court of Appeal in *Bogg* is interesting for it assumes that the language in a trust deed is necessarily the language of the settlor. Whilst it is true that the Settlor settles the trust and must be taken to have agreed the language, it is equally true that all of us are accustomed to boilerplate exclusion of liability clauses which are automatically inserted in trust deeds produced oftentimes by professional trustee firms which are never the subject of negotiations and agreement in the real sense but are rather seen as standard clauses. The decision in *Bogg* therefore does not provide an entirely satisfactory answer on this point.

16. The last in the troika of cases was *Wight v Olswang (No 2)*\(^7\) in which the English Court of Appeal had to interpret a trust deed containing two exemption clauses which were inconsistent. The first clause appeared to apply to trustees generally and excluded all liability save for wilful and individual fraud and wrongdoing. The second clause provided that no trustee (other than a trustee charging

\(^6\) (1998/99) 1 ITELR 267
\(^7\) (1999/2000) 2 ITELR 689
remuneration for so acting) should be liable for any error of judgment or mistake of law or other mistake or for anything save wilful misconduct or wilful breach of trust. The exclusion of paid trustees from the second clause suggested a lesser degree of protection for such a trustee. But this was contradicted by the first clause which provided far wider protection. The Court held that the first clause had to be read subject to the second so that paid trustees enjoyed a lesser degree of protection from liability.

17. These cases starting with *Armitage* have stood as the authoritative position on the issue of limits of exclusion of liability clauses in trust deeds until the Privy Council was asked to look afresh at the matter in *Spread Trustee Co. Ltd.*

**The Decision in Spread Trustee Co. Ltd.**

18. This was an appeal from Guernsey to the Privy Council.

19. The trust instruments dating from 1977 contained trustee exclusion of liability clauses which provided:

“In the execution of the trusts and powers hereof no trustee shall be liable for any loss to the Trust Fund arising in consequence of the failure depreciation or loss of any investments made in good faith or by reason of any mistake or omission made in good faith or of any other matter or thing except wilful and individual fraud and wrongdoing on the part of the trustee who is sought to be made liable”

20. On 22 April 1989, the *Trusts (Guernsey) Law 1989* came into force, s34 (7) of which provided:

“Nothing in the terms of a trust shall relieve a trustee of liability for breach of trust arising from his own fraud or wilful misconduct”.

21. On 19 February 1991, an amendment to this provision came into force, which added the words “or gross negligence” at the very end of the provision.

22. Guernsey therefore had moved legislatively to prevent a trustee from escaping the consequences of its own gross negligence.
23. Whilst the decision in the Privy Council turned on an examination of the legislative and customary law of Guernsey, what emerges from the decision is that the law in this area is far from settled. The Board unanimously found that the amendments to the Guernsey law could not have retroactive effect so that the exemption from liability clauses in the trust deeds dating back to 1977 could not be affected by the 1991 amendment.

24. On the separate question of whether the concept of fraud in the Act encompassed a grossly negligent breach of trust on the application of the maxim *culpa lata dolo aequiparatur* (“gross negligence is to be equated with fraud”) the majority (3:2) were of the view that fraud did not and could not encompass gross negligence.

25. Some reliance was placed on the decision in *Midland Bank v Federated Pension Services*\(^8\) where the Jersey Court of Appeal summarised the requirements both of wilful misconduct and of gross negligence thus:

> “Wilful misconduct does require appreciation by the person guilty of misconduct that what this person is doing is contrary to his duty as trustee, alternatively recklessness consisting of this person’s shutting his eyes to the probability that his misconduct is in breach of duty”

> “… the approach [in the authorities] was to treat ‘gross negligence’ as meaning ‘very great negligence’ or flagrant and extreme negligence, or negligence consisting of ‘a very marked departure from the standards’ of responsible and competent people. In none of them was it suggested that ‘gross negligence’ involved either ‘a certain mens rea’ or ‘an intentional disregard of danger’ or ‘recklessness’… In our judgment, the direction to the Jurats in the present case as to the meaning of ‘gross negligence’ was erroneous. All that this phrase means is a serious or flagrant degree of negligence. It does not import any question of intentional or reckless fault…”

26. On the further question of whether under the pre-existing customary law of Guernsey it had not been possible to exclude liability for grossly negligent breaches of duty, the Privy Council found on a majority view that there was no such prohibition on the exclusion of liability under customary law of Guernsey. The conclusion of the majority was that a Guernsey court in 1989 would have looked to English law to determine whether a trust instrument could properly permit the exclusion of liability by a trustee for the trustee’s gross negligence.

\(^8\) [1995] JLR 352 (CA)
Having looked to English law, English law would have permitted and continues to permit exclusion from liability for a trustee’s grossly negligent breach of trust. Lord Clarke in the majority refused to accept that the “irreducible core” of a trustee’s obligations should in fact also encompass a duty not to act with gross negligence.

27. Lord Clarke in the majority put it thus:

“First, where, as here, what is alleged against the trustee is a breach of the duty of care owed to the beneficiaries by the trustee, the fiduciary duties of the trustee are of no relevance. Nothing in the fiduciary duties owed by the trustee alters the standard of the duty of care owed by it. In the opinion of the Board, the suggestion that the standard of the duty of care owed by the trustee is somehow elevated by reference to concomitant fiduciary duties elides the fundamental distinction between the fiduciary duties owed by the trustee on the one hand and the duty to exercise care and skill owed by the trustee on the other. Secondly, the exemption from liability in respect of a trustee’s gross negligence is not inimical to the fiduciary duties owed by a trustee for the simple reason that the absence of honesty and good faith inherent in the failure to perform fiduciary duties would take such conduct outside the scope of such an exemption.”

28. This reasoning has attracted some criticism. Writing in the STEP Journal in September 2011 Giles Richardson in a careful analysis of the decision in Spread Trustee Co. Ltd. stated of Lord Clarke’s reasoning:

“This reasoning is not necessarily immune from criticism. As to Lord Clarke’s first point, it may be considered good as far as it goes, but it fails to address the normative question of whether because someone is a fiduciary, they ought not to be able to escape liability for grossly negligent breaches of their duties of care and skill. Trustees’ fiduciary duties flow ultimately from the perceived peculiar vulnerability of beneficiaries that required the courts to develop the stringent duties of loyalty to which trustees are subject. Respectable arguments can be made, and have carried the day before, for instance before Scottish judges and the Jersey and Guernsey legislatures, that beneficiaries also ought not to be exposed to the effects of gross negligence by their trustees but should have a right that the trustee cannot take away to seek redress for such conduct. There is no elision of concepts there; merely a recognition that the fiduciary context ought to tell the courts something about what beneficiaries should also have a right to expect of their trustees in relation to the care and skill they exercise.”
29. Lord Kerr in the minority quoted in extenso from the judgment of Millet, LJ in *Armitage* where Millet, LJ himself expressed some doubts as to the policy behind permitting trustees such broad latitude of exemption:

“… it must be acknowledged that the view is widely held that these clauses have gone too far, and that the trustees who charge for their services and who, as professional men, would not dream of excluding liability for ordinary professional negligence should not be able to rely on a trustee exemption clause excluding liability for gross negligence. Jersey introduced a law in 1989 which denies effect to a trustee exemption clause which purports to absolve a trustee from liability for his own ‘fraud, wilful misconduct or gross negligence’. The subject is presently under consideration in this country by the Trust Law Committee under the chairmanship of Sir John Vinelott. If clauses such as clause 15 are to be denied effect, then in my opinion this should be done by parliament, which will have the advantage of wide consultation with interested bodies and the advice of the Trust Law Committee”.

30. Lord Kerr continued:

“It is interesting to consider how a Guernsey court in 1988 would have reacted to the suggestion that it should follow English law in this area, if a statement such as that set out in the preceding paragraph had been then available. It seems to me to be entirely probable that it would have been extremely reluctant to follow English law on this question, not only because of the reservations about its propriety that appear to be implied in the passage quoted but also because the principle that a trustee was required to act as a bon père de famille was so deeply embedded in Guernsey customary law.”

The Notion of Gross Negligence

31. In *Camarata Property Inc v. Credit Suisse*⁹, Smith J sitting in the Commercial Court in England stated in construing an exclusion of liability clause in a commercial agreement:

“… as Mance J recognised in *Red Sea Tankers Ltd v Papachristidis (The "Ardent")* [1997] 2 Lloyd's Rep 547, 586, "If the matter is viewed according to purely English

⁹ [2011] EWHC 429
principles of construction, . . . "Gross" negligence is clearly intended to represent something more fundamental than failure to exercise proper skill and/or care constituting negligence", and there is no reason to depart from conventional English law principles of construction when giving effect to para 1.1. Mance J continued, " . . . as a matter of ordinary language and general impression, the concept of gross negligence seems to me capable of embracing not only conduct undertaken with actual appreciation of the risks involved, but also serious regard\textsuperscript{10} of or indifference to an obvious risk".

Observations

32. The debate appears now to be settled so far as the majority view in \textit{Spread Trustee Co Ltd.} is concerned but it must leave a slightly bitter taste in the mouths of so many who expect higher standards from their trustee. In the Eastern Caribbean and the trust jurisdictions there such as Nevis, the Privy Council is the final court of appeal and so the majority decision in this case is likely to be treated as the authoritative view going forward. That view seems to be that only Parliament can intervene to address this wide latitude of forgiveness being offered to trustees.

33. The language used in the cases is far from clear and the narrow majority in the Privy Council in \textit{Spread Trustee Co. Ltd} underscores the lack of clarity in this area.

34. When regard is had to the language of Millet, LJ is \textit{Armitage} that "[The clause] exempts the trustee from liability for loss or damage to the trust property no matter how indolent, imprudent, lacking in diligence, negligent or wilful he may have been, so long as has not acted dishonestly", it does appear that the law has leaned too far in favour of a trustee. It is not at all clear how such a liberal view of a trustee’s lack of culpability squares with the irreducible core duty of prudence in the management of the affairs of the trust.

35. Indeed, if Mance J was correct in \textit{Red Sea Tankers Ltd v Papachristidis (The "Ardent") [1997] 2 Lloyd’s Rep 547} that "as a matter of ordinary language and general impression, the concept of gross negligence seems to me capable of embracing not only conduct undertaken with actual appreciation of the risks involved, but also serious regard\textsuperscript{11} of or indifference to an obvious risk", then it

\textsuperscript{10} I suspect the learned Judge meant “disregard”.

\textsuperscript{11} See note 10 above
seems that “gross negligence” in a commercial setting approximates very closely to recklessness or as it were closing one’s eyes to the obvious risks involved in a particular course of conduct. This would suggest some slightly different treatment in the law of trusts.

36. In **Midland Bank v Federated Pension Services** cited earlier the Jersey Court of Appeal distinguished wilful misconduct (from which there is no escape for a trustee) from gross negligence (from which there is escape for a trustee). Interestingly wilful misconduct was seen as requiring “appreciation by the person guilty of misconduct that what this person is doing is contrary to his duty as trustee, alternatively recklessness consisting of this person’s shutting his eyes to the probability that his misconduct is in breach of duty”.

37. This seems eerily similar to the language employed by Mance, J in **Red Sea Tankers Ltd v Papachristidis (The "Ardent")** to describe gross negligence albeit in a non trust context.

38. Section 14 of the Nevis International Exempt Trust Ordinance, 1994, as amended, which governs international trusts formed in Nevis does not help the situation. It provides as the pre **Spread Trustee Co. Ltd.** Guernsey position that “Nothing in the terms of a trust shall relieve a trustee of liability for a breach of trust arising from his own fraud or wilful misconduct”. A Nevis court then will have little choice but to apply the majority position in **Spread Trustee Co. Ltd.**

39. The concerns however remain and appear even more potent when regard is had to the fact that many trustees in modern jurisdictions are professional trustees. Surely it would seem that a professional trustee should be held to a higher standard of care, a higher standard of prudence, a lower standard of exclusion from liability. Yet that argument has been rejected by the courts. It seems exceedingly odd that a lay trustee can be held to the very same standard as a highly paid professional trustee so that negligence however gross on the part of either, is readily forgiven by the use of a boiler plate exclusion of liability clause.

40. It seems now the Privy Council having ruled, that trustees in the Eastern Caribbean can breathe a sigh of relief and can proceed merrily along regardless of the flagrancy of their negligence and the loss caused thereby to beneficiaries provided they have the usual exclusion of liability clauses in their trust deed. Beneficiaries for their part get to pay professional trustees for the privilege.
41. If the court will not intervene to deal with this then it must fall to the legislature to do so and I expect that the necessary amendments will come to Nevis in due course. Barring such legislative action, it behoves settlors to require that appropriate exclusion of liability clauses are inserted into trust deeds to ensure that trustees are held accountable for their actions in the administration of their trusts.

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